SHEARMAN & STERLING
IN ASSOCIATION WITH DR. SULTAN ALMASOUD & PARTNERS

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CMA Announces New Rules for Ownership in Listed Companies by Foreign Strategic Investors

As part of the Kingdom of Saudi Arabia's efforts to regulate and develop the capital markets and to facilitate foreign investment, the Capital Market Authority ("CMA") has approved the Instructions for Foreign Strategic Investors' Ownership in Listed Companies (the "FSI Instructions"), which came into effect on 26 June, 2019. The FSI Instructions have removed the existing limit on the foreign[1] ownership of a Saudi-listed company for foreign strategic investors ("FSIs") that meet the FSI Instructions' criteria, allowing them to take controlling stakes in Saudi-listed companies.

The FSI Instructions are complementary to the "Rules for Qualified Foreign Financial Institutions Investment in Listed Securities" (the "QFI Rules") approved by the CMA in 2015 (as amended).

QFI Rules

Foreign ownership of shares in publicly listed companies in the Kingdom has traditionally been a heavily regulated regime. Until the introduction of the QFI Rules in 2015, foreign investors could not invest directly in Tadawul-listed securities and instead were only able to invest indirectly through swap agreements with CMA-authorised persons.

A qualified foreign investor ("QFI") is a foreign investor that is permitted to invest directly in securities listed on the Saudi Stock Exchange (Tadawul) pursuant to the QFI Rules. The QFI Rules set out the procedures, requirements and conditions for the registration of QFIs by assessing authorised persons (i.e. persons authorised by the CMA to conduct custody or dealing activities that assess QFI applications), as well as the obligations of QFIs and of assessing authorised persons in this regard.

The QFI Rules, which have since developed over subsequent years, opened up the landscape of the Kingdom's capital market and expanded the market's investor base. As of 30 June 2019, QFIs hold 3.99% of shares listed on the Main Market of Tadawul and 0.33% of shares listed on the Parallel Market of Tadawul.[2]

It is worth noting that the QFIs are subject to the following investment restrictions:

- A QFI cannot own more than 10% of the shares or convertible debt instruments of any Tadawul-listed issuer.

[1] Under the current regulatory regime, GCC citizens and foreign citizens resident in the Kingdom can invest directly in Saudi-listed securities. For this purpose, **GCC citizens** are (1) natural persons who hold citizenship of one of the Cooperation Council for the Arab States of the Gulf countries, or (2) legal persons that (a) the capital of which is majority owned by citizens or governments of the Cooperation Council for the Arab states of the Gulf countries; and (b) are holding the citizenship of one of the Cooperation Council for the Arab states of the Gulf countries in accordance with the definition set out in the resolution of the Supreme Council of the Cooperation Council for the Arab States of the Gulf in its 15th session approved by the Council of Ministers Resolution number (16) dated 20/1/1418H.

[2] Tadawul's Monthly Stock Market Ownership and Trading Activity Report for the month ended 30 June 2019.

- All foreign investors (in all categories, whether resident or non-resident, excluding FSIs (see below) and those investing through swap agreements) cannot own in aggregate more than 49% of the shares or convertible debt instruments of any Tadawul-listed issuer.
- Limitations set out in the bylaws of the listed companies or any instructions issued by the regulatory and supervisory authorities to which such companies are subject.
- Other legislative limitations on foreign ownership of joint stock companies.

Summary of FSI Instructions[3]

- Except for the provisions regarding the two-year lock-up period described below, the provisions of the FSI Instructions apply to foreign legal entities (other than QFIs) who directly owned shares in companies listed on the Main Market of Tadawul before the FSI Instructions became effective.[4] Such entities are commonly referred to "strategic partners" and include foreign investors considered founders and partners of Saudi-listed companies. As of 30 June 2019, strategic partners held 2.79% of shares listed on the Main Market.[5]
- An FSI is a foreign legal entity that aims to directly own a percentage (or a "strategic shareholding") of shares in listed companies in the Kingdom. The aim of a strategic shareholding is to contribute in promoting the financial or operational performance of the listed company.
- In order to qualify as an FSI, a foreign investor must:
    - be established or licensed in a country[6] that applies regulatory and supervisory measures similar to those applied by the CMA or are accepted by it;
    - have a client account with a CMA-authorised person and a portfolio account with the Securities Depositary Centre (Edaa); and
    - satisfy any other requirements or conditions as the CMA requires.
- FSIs can acquire strategic shareholdings in listed companies by buying shares directly on the market, through private transactions, by offering to

[3] The CMA has also updated its FAQs for Implementing Regulations webpage to provide answers to frequently asked questions regarding FSIs (https://cma.org.sa/en/RulesRegulations/FAQ/Pages/FAQs.aspx).

[4] It is assumed that the reason for the disapplication of the two-year lock period for such foreign investors is that the listed shares held by such foreign investors are already subject to the transfer restriction imposed by the CMA. Any transfer of such shares will require the prior approval of the CMA.

[5] Tadawul's Monthly Stock Market Ownership and Trading Activity Report for the month ended 30 June 2019.

[6] These are the member states of the International Organization of Securities Commissions (IOSCO) that are applying and cooperating in anti-money laundering and financing of terrorism in accordance with the Financial Action Task Force (FATF) in a manner that does not conflict with the relevant laws in force in the Kingdom and published by the Anti-Money Laundering Permanent Committee.

purchase shares under the Merger & Acquisition Regulations or via initial public offerings.[7]

- The FSI Instructions do not set either a minimum or maximum ownership limit for a strategic shareholding. FSIs are exempt from the 49% foreign ownership limit set by the QFI Rules. However, the following restrictions apply to investments by FSIs:
    - Limitations set out in the bylaws of the listed companies or any instructions issued by the regulatory and supervisory authorities to which such companies are subject.
    - Other legislative limitations on foreign ownership of joint stock companies.8
    - An FSI may not dispose of any of the shares it owns in accordance with the FSI Instructions within a period of two years after the date of becoming the owner of such shares.
- A foreign investor cannot be an FSI and a QFI owning shares in the same issuer at the same time. If a foreign investor wishes to convert from an FSI to a QFI to hold shares in the same issuer or vice versa, it must meet the relevant requirements set out in the FSI Instructions or the QFI Rules (as applicable) and transfer all shares from the FSI account to the QFI account or vice versa (as applicable). A foreign investor can be an FSI and a QFI on Tadawul at the same time.

Other Considerations

Regulatory Approvals

As noted above, FSIs will still be subject to limitations issued by industry regulators and supervisors, particularly for listed companies operating in sectors such as telecommunications, banking and insurance. In these cases, any changes in the ownership stake of an FSI may need to be approved by the relevant regulator. This means that, in addition to the two-year lock-up period described above, FSIs may require additional approvals before being able to sell all or part of its strategic shareholding.

Competition Approval

The General Authority of Competition ("GAC") expects to review and vet transactions related to mergers and acquisitions in key sectors in the Saudi market, specifically relating to listed companies, to determine if a transaction, in GAC's view, would result in economic concentration.[9]

The Kingdom's competition laws provide that where a company wishes to acquire shares which would result in economic concentration, it must

[7] It is assumed that the definition of "participating parties" in the CMA's Instructions of Book Building Process and Allocation Method in Initial Public Offerings (IPOs) will be updated in due course to expressly include FSIs as persons permitted to participate in IPOs during the book building process.

[8] Currently, foreign investors are not permitted to own shares of companies (such as Jamal Omar Development Company) that invest in the development of the Holy Cities of Makkah and Madinah.

[9] The Implementing Regulations of the Competition Law define "economic concentration" as any act resulting in full or partial transfer of ownership rights or usufruct of an entity's properties, rights, stocks, shares or obligations to another entity that puts an entity or a group of entities in a position of domination of an entity or a group of entities, by way of merger, takeover, acquisition, or combining two or more managements into one joint management or any other means which leads to having a market share of 40% of the total sales of a commodity in the market.

seek the approval of GAC prior to completion of the acquisition. The review period of an economic concentration application is 60 days, which can be extended by GAC if it considers that additional time is required to complete its review of the application. GAC has previously issued fines to companies that have not sought GAC's review prior to proceeding with relevant transactions which would result in economic concentration.

M&A Regulations

If an FSI, following CMA approval, acquires 50% or more of voting shares in a Saudi-listed company, the CMA has the right to require such person to make a mandatory takeover offer ("MTO") to all shareholders of the target.

The CMA is, however, entitled to grant waivers from any provisions of the M&A Regulations based on a submitted request, or its own initiative. For example, the CMA recently approved an FSI's increase of its stake in a listed company to 51% without enforcing an obligation on such FSI to make an MTO.

Listing Rules

Under the Listing Rules of Tadawul, the minimum float requirement is 30% for companies listed on the Main Market and 20% for companies listed on the Parallel Market, unless a lower threshold is approved by the CMA. This minimum float requirement is a continuing obligation on the issuer. Therefore, despite the FSI Instructions not imposing any upper limit on a strategic shareholding, a 70% stake in a Main Market issuer and a 80% stake in a Parallel Market issuer may be the maximum attainable for an FSI at any given time, subject to the other investment limitations referred to above.

Concluding Remarks

The introduction of the FSI Instructions is a significant step towards solidifying Tadawul as the major exchange in the MENA region, ensuring that foreign direct investors who intend to invest in the region are not faced with excessive regulatory obstacles.

As the Kingdom takes proactive steps towards deregulation, local shares have recently been introduced into the FTSE emerging-market index and the MSCI emerging market benchmark, in March and May earlier this year, respectively, attracting further foreign investment into the market.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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